



UNITED STATES OF AMERICA  
DEPARTMENT OF TRANSPORTATION  
OFFICE OF THE SECRETARY  
WASHINGTON, D.C.

Order 99-1 1-20

SERVED: November 30, 1999

Issued by the Department of Transportation  
on the 30<sup>th</sup> day of November, 1999

Joint Application of

**ALITALIA-LINEE AEREE ITALIANE-S.p.A.**  
**KLM ROYAL DUTCH AIRLINES**  
**NORTHWEST AIRLINES, INC.**

for approval of and Antitrust Immunity for Alliance  
Agreements pursuant to 49 U.S.C. §§ 41308 and 41309

Docket OST-1999-5674 - 34

**ORDER TO SHOW CAUSE**

By this order, we tentatively grant approval of and antitrust immunity for (1) a Commercial Cooperation & Integration Agreement<sup>1</sup> between Northwest Airlines, Inc. ("Northwest") and Alitalia Linee Aeree Italiane-S.p.A. ("Alitalia"); and (2) an Alliance Coordination Agreement\* among Northwest, Alitalia, and KLM Royal Dutch Airlines ("KLM"), and their respective subsidiaries, collectively referred to herein as the "Alliance Agreements," under 49 U.S.C. §§ 41308 and 41309. Our action here is subject to the various terms, conditions, provisions and limitations imposed by the Department of Transportation ("the Department") in Order 93-1-11, dated January 11, 1993. If made final, we will direct the Joint Applicants to resubmit their Alliance Agreements no later than January 11, 2003 and if the Joint Applicants choose to operate under a common name or brand, they will have to obtain advance approval from the Department before implementing the arrangement.

As an express condition to the grant of antitrust immunity to the Alliance, we also direct Northwest, KLM and Alitalia to withdraw from all International Air Transport Association ("IATA") tariff conference activities affecting through prices between the United States and Italy and for other markets described below. We further propose to direct Alitalia to report full-itinerary Origin-Destination Survey of Airline Passenger Traffic data ("O&D Survey") for all passenger itineraries that include a United States point (similar to the O&D Survey data already

<sup>1</sup> Exhibit JA-1 of the application.

<sup>2</sup> Exhibit JA-2 of the application.

reported by its partner Northwest)? We further tentatively find it appropriate to condition our approval as more fully explained below. We are providing Northwest, **KLM**, **Alitalia**, and other interested parties the opportunity to comment on these tentative findings.

## **I. Background**

### **A. Northwest and KLM's Existing Alliance Arrangement**

By Order **93-1-11**, issued January 11, 1993, the Department granted **final** approval and antitrust immunity for a Cooperation and Integration Agreement between Northwest and **KLM**. The Department's action in that matter allowed the two carriers to integrate their services and operate as if they were a single carrier.

### **B. The Open-Skies Agreement with Italy**

On November 11, 1998, the United States and Italy initialed an open-skies **agreement**.<sup>4</sup> The predicate for our approval and grant of antitrust immunity for the **Northwest-Alitalia** alliance is the existence of the expansive, new aviation agreement between the United States and Italy. When fully implemented, the new accord will allow any U.S. airline to serve any point in Italy (and open intermediate and beyond rights) from any point in the United States and allows any Italian airline to do the same. An open-skies aviation regime should also encourage new competitive service in the U.S.-Italy marketplace. Since market forces, not restrictive agreements, will discipline the price and quality of U.S.-Italy airline service U.S. travelers will have an incentive to travel through Italy to points beyond, in competition with services offered through other European gateways.

## **II. The Northwest and Alitalia Alliance Agreement**

This joint application concerns two agreements: (1) an Alliance Agreement between Northwest and **Alitalia**, and (2) a Coordination Agreement among **Alitalia**, Northwest, and **KLM**. Each of these agreements further develops the already approved and immunized alliance between Northwest and **KLM**, which will remain in effect. The Joint Applicants state that the proposed Alliance Agreement is comparable to the Northwest-KIM agreement in that it provides a contractual framework for cooperation in all major functional areas of the airlines' operations, while the Coordination Agreement provides for integration of all three carriers as a single operational entity.

For example, the Alliance Agreements provide for route and schedule planning and coordination; establishment and management of marketing, advertising, sales and distribution networks, **staffs**, programs, policies, and systems; branding/co-branding and product development (including, an "alliance mark" to represent their alliance and frequent flyer program linkage); code-sharing;

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<sup>3</sup> **KLM** is already subject to this **O&D** Survey reporting requirement.

<sup>4</sup> Protocol between the Government of the United States and the Government of the Italian Republic to amend the Air Transport Agreement of June **22, 1970** (initialed, ad referendum, November 11, 1998).

coordinated pricing, inventory and yield management; revenue pooling and sharing; joint procurement of goods and services, including station and ground handling services, general goods and services, catering, fuel and maintenance; coordinated cargo programs and distribution of cargo services; integration design, and development of information systems (including inventory control and yield management functions); coordination and integration of frequent flyer programs; coordination of revenue and cost accounting practices; sharing of facilities and services at airports; provision of aircraft and ground equipment and technical and maintenance services; and the establishment of a Committee to administer coordination and to oversee and manage the partners' cooperative activities.

In short, the proposed Alliance Agreements, if approved, will allow the Joint Applicants effectively to operate much as a single firm, while retaining their individual identities, brands, ownership, and control. The joint application does not involve any exchange of equity or other forms of cross-ownership.

### III. The Application and Responsive Pleadings

#### A. The Joint Applicants' Request

On May 11, 1999, the Joint Applicants filed an application seeking approval of and antitrust immunity for an Alliance Agreement, for a five-year term. They state that the purpose of the proposed arrangement is to establish a legal framework enabling the expansion of the exiting Northwest-KIM alliance to include **Alitalia**, while permitting each of the three partners to retain its independent corporate and national identity.<sup>5</sup> While the arrangement does not involve any exchange of equity or other forms of **cross-ownership**,<sup>6</sup> they state that the objective of the Alliance Agreement is to enable the partners to plan and coordinate service over their respective route networks as if they were a single entity. They also advise that they will not go **forward** with their plans absent antitrust **immunity**.<sup>7</sup>

The Joint Applicants assert that the public and commercial benefits promoted by the proposed arrangement and U.S. international aviation policy support granting their request. They represent that their alliance will produce significant network synergies by creating a coordinated network of competitive network services between the United States and Italy and beyond, and producing cost efficiencies and savings through integration and coordination that can be passed on to consumers, as global competition between alliances increases. They assert that the alliance will create a seamless **Northwest-KLM-Alitalia** network that will enhance competition in the U.S.-Italy market and the worldwide marketplace by enabling the partners to compete with other global alliances, thereby increasing global competition. Their view is that the alliance cannot achieve the expected benefits and efficiencies absent antitrust immunity.

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<sup>5</sup> Application at 6.

<sup>6</sup> Application at 6.

<sup>7</sup> Application at 2. Also, see Article 4.2 of the Alliance Coordination Agreement.

The Joint Applicants maintain that the proposed alliance will not substantially reduce or eliminate competition in any relevant market.<sup>8</sup> Indeed, they argue that a fully implemented alliance will enable them to increase their competitiveness, placing additional commercial pressure on rival European airlines and other existing global network systems.

They argue that in the U.S.-Europe market the alliance's market share will be smaller than the shares of the other transatlantic alliances and in several cases will be smaller than the market shares of individual carriers, including, British Airways, American Airlines and Delta Air Lines.<sup>9</sup> They state that not only will the addition of **Alitalia** make the **Northwest-KLM** alliance a stronger transatlantic competitor, but that the introduction of U.S.-Italy open skies will provide other airlines and alliances with new opportunities to develop their services and compete for transatlantic market share.

Regarding the U.S.-Italy market, the Joint Applicants note that numerous U.S. and Italian airlines have expressed an interest in entering, or expanding existing services in, the market once the regulatory environment has been liberalized.<sup>10</sup> Moreover, the Joint Applicants maintain that once implemented the level of concentration in the U.S.-Italy market will be further diminished by open skies.

Regarding the city-pair markets, the Joint Applicants argue that the proposed arrangement will not reduce the number of competitors in any city-pair market. Moreover, they assert that even if the alliance carriers capture a large share of the nonstop **traffic** between Northwest's hubs at Minneapolis-St. Paul and Detroit, on the one hand, and **Alitalia's** hubs at Rome and Milan, on the other hand, these city-pair markets do not now have nonstop service.<sup>11</sup>

The Joint Applicants also maintain that approval of their application will promote aviation liberalization, development of competitive airline networks and provide other public benefits including increased trade ties and job opportunities.

Finally, the applicants state that the grant of antitrust immunity here should also cover the coordination of (1) the presentation and sale of the carriers' airline services in computer reservations system ("**CRS**"), and (2) the operations of their respective internal reservations systems. The Joint Applicants state that they are prepared to consent to the imposition of the condition prohibiting participation in certain **IATA** tariff coordination activities. They are prepared to consent to a condition restricting the use of a common service name or brand absent

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<sup>8</sup> American Airlines, Continental Airlines, Delta Air Lines, **Trans** World Airlines, United Airlines, and US Airways provide scheduled, nonstop service in the U.S.-Italy market. Source: Official Airline Guides, Inc., August 1999.

<sup>9</sup> **Alitalia** states that its share of the U.S.-Europe market is only about 2 percent of seats and departures. Also, the Joint Applicants state that their combined market shares will be about 10 percent of seats and departures. Application at 18.

<sup>10</sup> Application at 23-25.

<sup>11</sup> They state that the primary reason for the alliance to establish nonstop Minneapolis/St. Paul/Detroit-Rome/Milan services will be to create new nonstop links between Northwest's and **Alitalia's** respective behind and beyond gateway networks rather than to dominate these city-pair markets. In any case, they say that if the alliance were to raise prices above competitive levels, passengers could elect to use many alternative one-stop services through other, non-circuitous gateways such as Chicago and New York.

separate approval by the Department, and they agree to accept the O&D Survey data-reporting requirement, consistent with the Department's actions in other antitrust immunity cases.

## Responsive Pleadings

### 1. Trans World Airlines, Inc

On May 20, 1999, TWA filed an answer requesting dismissal of the application without prejudice. In the alternative, it urged the Department to suspend action on the application until various issues concerning the continued immunity status of the Northwest-KIM alliance and Northwest's control of Continental Airlines, Inc. ("Continental") are decided. In this regard, TWA states that the issue of renewal of antitrust immunity for that alliance is now before the Department; and that Northwest has acquired voting control of Continental-an action that has been challenged by the U.S. Department of Justice.

TWA maintained that the application was incomplete in several respects? Among other things, TWA noted that the application failed to address Continental's relationship with the proposed alliance.<sup>13</sup> TWA stated that Northwest had acquired voting control of Continental, and therefore the two carriers would pursue joint strategic objectives, including joint participation in the alliance with **KLM** and **Alitalia**. TWA argued that even if Continental were not yet a formal member of the alliance, its relationship with Northwest would provide an anticompetitive link between Continental and **Alitalia**. TWA argued that an alliance in which both Continental, either directly or indirectly, and **Alitalia** are partners raises serious competitive issues, since they are the two largest carriers in the U.S.-Italy market.

TWA stated that the Department should not grant this application before it reaches a final decision on whether antitrust immunity should be "renewed" for the **Northwest-KLM** alliance. TWA is also of the view that the Department should investigate the need for immunity for all other alliances, since it views alliances as having an adverse effect on U.S. carrier market share of transatlantic traffic.

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<sup>12</sup> By Order **99-5-10**, issued May 21, 1999, the Department directed the Joint Applicants to provide additional information to supplement their application. At that time, we suspended our procedural schedule in this case. We also stated that when we determined that the application was complete, we would establish an appropriate schedule for the filing of responsive pleadings.

<sup>13</sup> On May 25, 1999, TWA filed a petition for reconsideration of Order **99-5-10**. TWA argued that, in addition to the information/data requested by the Department, the Joint Applicants should also be required specifically to provide the record with any information about the impact of the proposed alliance and the grant of antitrust immunity upon competition between Continental and **Alitalia**.

On June 4, 1999, Continental filed an answer opposing TWA's petition. It argued that Northwest did not control Continental and that the alliance among the Joint Applicants will have no impact upon competition between Continental and **Alitalia**.

On June 14, 1999, TWA filed a reply arguing that recent **Alitalia** press releases substantiated its concern about the role of Continental in the proposed alliance, and the impact of the alliance on competition in the U.S.-Italy market.

By Notice dated June 22, 1999, we directed the Joint Applicants to provide this relevant information. On July 15, 1999, the Joint Applicants filed information addressing each of these issues.

Based on our evaluation of these supplemental filings, we found that the record of this case was substantially complete, and established procedural deadlines. We also provided to the interested parties' counsel and outside experts interim access to the confidential information filed in this docket, subject to certain affidavit procedures and requirements. See Notice dated July 19, 1999.

## 2. The American Society of Travel Agents, Inc. ("ASTA")

On May 24, 1999, ASTA filed comments asking the Department not to immunize the proposed arrangement. ASTA stated that it is opposed to the grant of additional antitrust immunity to airlines for marketing alliances and other joint ventures. ASTA said that if these arrangements are pro-consumer and pro-competitive there should be no need to immunize them from U.S. laws. ASTA stated that it is supporting legislation that would prevent the future grant of antitrust immunity.

## 3. American Airlines, Inc. ("American")

On August 9, 1999, American filed an answer urging the Department to grant contemporaneously its application for U.S.-Italy authority, in the event that the Department grants and immunizes the proposed arrangement, which would cause the open-skies provisions of the U.S.-Italy agreement to take effect.

## 4. The IAM

The International Association of Machinists and Aerospace Workers filed pleadings opposing the application. It maintains that the application is not in the public interest because it will reduce competition due to existing overlap between Northwest and Continental, and because Alitalia does not have an acceptable labor relations record, as reflected by "its most recent demonstration of bad faith bargaining with the IAM". The IAM also maintained that the Joint Application is deficient because it does not address key issues and facts, such as Continental's role in the new alliance.

The Joint Applicants and Continental have replied to the IAM's pleadings. They argue that the proposed alliance will enhance competition; that Continental and Northwest remain competitors, not collaborators; and that the Continental-Alitalia code-share arrangement is entirely separate and distinct from the proposed Northwest-KLM-Alitalia alliance.

On November 26, 1999 the IAM moved to withdraw the objections and pleadings it filed in this docket. We will grant its motion.

## IV. Tentative Decision

We tentatively find that approving and granting antitrust immunity to the Alliance Agreements under §§ 41308 and 41309 is in the public interest' subject to conditions. If made final, we will require Joint Applicants (1) to withdraw from all International Air Transport Association (IATA) tariff conference activities relating to through prices between the United States and Italy, as well as between the United States and the homeland(s) of foreign carriers participating with U.S. carriers in other immunized alliances; (2) to file all subsidiary and subsequent agreement(s) with the Department for prior approval; and (3) to resubmit for renewal their Alliance Agreements before January 11, 2003. We also tentatively find it in the public interest to direct

Alitalia to report full-itinerary O&D Survey data for all passenger itineraries that contain a Unitpoint (similar to the O&D Survey data already reported by Northwest). Finally, any final approval would be also subject to the various provisions and limitations provided for in Order 93-1-11, and any authorities granted pursuant to that final approval would be contingent upon the implementation of an open-skies agreement between the United States and Italy.

## **V. Decisional Standards under 49 U.S.C. Sections 41308 and 41309**

### **A. Section 41308**

Under 49 U.S.C. Section 41308, the Department has the discretion to exempt a person affected by an agreement under Section 41309 from the operations of the antitrust laws “to the extent necessary to allow the person to proceed with the transaction,” provided that the Department determines that the exemption is required by the public interest. It is not our policy to confer antitrust immunity simply on the grounds that an agreement does not violate the antitrust laws. We are willing to make exceptions, however, and thus grant immunity, if the parties to such an agreement would not otherwise go forward without it, and we find that the public interest requires that we grant antitrust immunity.

### **B. Section 41309**

Under 49 U.S.C. Section 41309, the Department must determine, among other things, that an intercarrier agreement is not adverse to the public interest and not in violation of the statute before granting approval.<sup>14</sup> The Department may not approve an inter-carrier agreement that *substantially* reduces or eliminates competition unless the agreement is necessary to meet a serious transportation need or to achieve important public benefits that cannot be met, and those benefits cannot be achieved, by reasonably available alternatives that are materially less anticompetitive.<sup>15</sup> The public benefits include international comity and foreign policy considerations.<sup>16</sup>

The party opposing the agreement or request has the burden of proving that it substantially reduces or eliminates competition and that less anticompetitive alternatives are **available**.<sup>17</sup> On the other hand, the party defending the agreement or request has the burden of proving the transportation need or public benefits.<sup>18</sup>

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<sup>14</sup> Section 41309(b).

<sup>15</sup> Section 41309(b)(1)(A) and (B).

<sup>16</sup> Section 41309(b)(1)(A).

<sup>17</sup> Section 41309(c)(2).

<sup>18</sup> *Id.*

## VI. Tentative Approval of the Agreement

### The Market Summary

The U.S.-Italy aviation market is one of our most important international aviation markets. Civil aviation is now critical to maintaining crucial cultural, economic and social links between the two countries. However, aviation's ability to meet the challenges of the dynamic U.S.-Italy relationship is now hampered by an old, restrictive air service agreement between the two countries that imposes extensive limitations on airline operations.

Only four U.S. airlines now provide U.S.-Italy scheduled passenger service-the maximum number permitted by the bilateral. These airlines provide a total of just seven daily frequencies per day in the market. Italy and the U.S. have also agreed to allow Continental to serve the market, but only pursuant to a joint service agreement with **Alitalia**.

**Alitalia** is the only other provider of U.S.-Italy scheduled passenger service. It provides more service in the market than any other airline. It operates more service than any individual U.S. airline, providing it with a **38%** market share.

Neither of **Alitalia's** proposed alliance partners -Northwest and **KLM** – is authorized to operate directly between the U.S. and Italy. Their participation in the market is limited to connecting passengers over Amsterdam. Consequently, the **Northwest/KLM** share of the U.S.-Italy market is negligible.

Italy and the U.S. have long recognized that the restrictive nature of their bilateral aviation relationship has adversely affected important cultural and economic ties, and restricted the growth of trade between the two countries. Both have worked hard to deal with this serious problem, and their efforts succeeded with a new U.S.-Italy open-skies aviation agreement. The agreement eliminates all existing barriers to new entry, expansion and competition created by government regulation of the market. It provides unrestricted competitive opportunities for all U.S. and Italian airlines, including the flexibility to operate their own direct services, or joint services with another airline. The new agreement recognizes the value of airline networks and provides open opportunities for competitive alliances to provide the services covered by the new accord.

It is against this background that we have tentatively decided to approve and grant antitrust immunity to the **Alitalia/ Northwest/KLM** alliance agreements before us, subject to the conditions noted above.

### The Public Benefit Summary

We tentatively find that proposed alliance would provide important public benefits. The parties state that it would permit Northwest to enter the U.S.-Italy market by providing new nonstop service between Minneapolis and Italy, and between Detroit and Italy. The inauguration of these nonstop services will richly benefit the people of Minneapolis, Detroit and their service



areas by bringing substantially improved service to Italy. This air service expansion is an important public benefit because the principal region served by these cities -the Midwest-has long sought, and has a demonstrable need for, enhanced service to Italy. The proposed alliance would also allow the applicants to improve the efficiency of their operations and to otherwise work together to improve service between the U.S. and Italy and between the U.S. and other international destinations.

Moreover, approval of the proposed alliance would facilitate the implementation of our new open-skies agreement with Italy and all of the significant public benefits that are likely to be made available by that landmark accord. In this regard it is significant that U.S. carriers ---- including the U.S. partners of existing transatlantic alliances- have already asked the Department for unrestricted authority to provide scheduled combination service to Italy.

### Competition Summary

We also tentatively find that it is unlikely that these alliance agreements as conditioned would substantially reduce or eliminate competition in any relevant market. The most significant structural consideration with respect to the impact of the proposed alliance is that **Alitalia** is not a major transatlantic competitor of **Northwest/KLM**, and therefore, it is unlikely that the public would lose any significant service because of the addition of **Alitalia** to the existing alliance. Approval of the alliance will increase the presence and share of the new partnership in the U.S.-Europe market. It could also increase concentration, but only slightly, and only to the extent that new service made possible by the U.S.-Italy open-skies agreement does not offset the loss of existing competition among the partners. More important, the record shows that competition from other airlines and alliances should force the new partnership to compete vigorously in the U.S.-Europe market.

We have reached the same tentative conclusion with respect to the U.S.-Italy market. The record shows that there is no significant competitive overlap among the Joint Applicants in this market. Therefore, approval of the alliance will not substantially reduce competition here. Approval could enhance U.S.-Italy competition, depending on considerations noted for the U.S.-Europe market.

The record also supports a tentative finding that the proposed arrangement will not reduce nonstop and single-plane competition in any city-pair.

Finally, it should be noted that the Department of Justice has reviewed the proposed transaction and that it has decided not to take action with respect to the transaction.

### **A. Antitrust Issues**

The Joint Applicants state that through the Alliance Agreements they intend to broaden and deepen their cooperation in order to improve efficiency, expand various benefits available to the traveling and shipping public, and enhance their ability to compete in the global marketplace. They state that, while retaining their separate corporate and national identities, they fully intend to cooperate to the extent necessary to create a seamless air transport system. Accordingly, the

Alliance Agreements' intended commercial and business effects are equivalent to those resulting from a merger of the three airlines. In determining whether the proposed transaction would violate the **antitrust** laws, we apply the Clayton Act test used in examining whether mergers will substantially reduce competition in any relevant market?

The Clayton Act test requires the Department to consider whether the Alliance Agreements will substantially reduce competition by eliminating actual or potential competition between Northwest, **Alitalia**, and **KLM** so that they would be able to effect **supra-competitive** pricing or reduce service below competitive levels.<sup>20</sup> To determine whether a merger or comparable transaction is likely to violate the Clayton Act, the Department of Justice and the Federal Trade Commission use their published merger guidelines.<sup>21</sup> The Merger Guidelines' general approach is that transactions should be blocked if they are likely to create or enhance market power, market power being defined as the ability profitably to maintain prices above competitive levels for a significant period of time (firms with market power can also harm customers by reducing product and service quality below competitive levels). To determine whether a proposed merger is likely to create or enhance market power, we primarily consider whether the merger would significantly increase concentration in the relevant markets, whether the merger raises concern about potential competitive effects in light of concentration in the market and other factors, and whether entry into the market would be timely, likely, and sufficient either to deter or to counteract a proposed merger's potential for harm.

The relevant markets requiring a competitive analysis are: first, the U.S.-Europe market; second, the U.S.-Italy market; and third, the city-pair markets. The record shows that the proposed Northwest and **Alitalia** alliance will only nominally increase concentration in the transatlantic market,\*\* and the U.S.-Italy market.<sup>23</sup> Likewise, these determinations also apply to the combination of the proposed **Northwest-Alitalia** alliance with the existing **Northwest-KLM** alliance.<sup>24</sup>

## 1. The U.S.-Europe Market

We tentatively find that the Alliance Agreements should not substantially reduce competition in the U.S.-Europe marketplace. The available data show that the U.S.-Europe nonstop passenger market shares for **Northwest-KLM**, and **Alitalia** were 9.36 percent and 1.9 percent, respectively, based on U.S.-Europe departures for Calendar 1998. Approval of the Joint Application could thus increase the market position of the new alliance to slightly over 10 percent. However, that increase should not produce market power, market concentration or other adverse competitive effects. The market share of the new alliance will be considerably smaller than the shares of

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<sup>19</sup> Order 92-11-27, at 13.

<sup>20</sup> *Id.*

<sup>21</sup> 57 Fed. Reg. 41552 (September 10, 1992).

<sup>22</sup> **Alitalia's** total transatlantic passenger market share was 1.9 percent, and Northwest's was 4.4 percent. Source: T-100 and T-100f nonstop segment and market data, for the 12 months ended December 1998.

<sup>23</sup> Northwest does not now serve the U.S.-Italy market, either on a direct or code-share basis.

<sup>24</sup> **Alitalia** and Northwest-I&M do not now serve common U.S. gateways in the U.S.-Italy market. Therefore, the Northwest-KIM alliance, joined by **Alitalia**, should not significantly affect competition at any U.S. gateway. **Alitalia's** alliance with **Northwest-KLM** will not create new barriers to entry into the markets affected by the alliance.

other transatlantic alliances and some individual airlines such as Delta and British Airways.<sup>25</sup> Approval of the joint application will thus not lead to a significant reduction of competition in the U.S.-Europe market.

Review of the U.S.-Europe market also indicates that the transatlantic **Herfindahl-Hirschman Indices (HHIs)**, as adjusted for the previously approved alliances, was about 1,307.<sup>26 27</sup> Under the **HHI** methodology the proposed blending of **Alitalia** with the existing **Northwest-KLM** alliance would increase the transatlantic **HHIs** to about 1,342, an increase in concentration of about 2.7 percent.<sup>28</sup> That figure is based on the conservative assumption that there will be no increase in service between the U.S. and Italy and other European aviation markets that will not offset any loss of service due to **Alitalia's** addition to an existing alliance. In fact, implementation of Open skies agreements have generally led to significant increases in competitive service, and the record in this case indicates that a US-Italy open-skies agreement will increase service and competition in that market.

## 2. The U.S.-Italy Market

Northwest and **Alitalia** do not currently compete to any significant extent in any transatlantic markets. Northwest itself does not operate any flights to **Italy**.<sup>29</sup> Moreover, **Alitalia** does not offer nonstop service in the U.S.-Netherlands market, and **KLM** does not offer nonstop service in the U.S.-Italy market. Although the record shows that in August 1999, **KLM** and **Alitalia** formed an alliance, creating "an operational merger of the two airlines' systems,"<sup>30</sup> we do not view the two airlines as significant competitors in either the U.S.-Netherlands or the U.S.-Italy markets. Thus, the recently implemented **Alitalia-KLM** arrangement will not result in any significant loss of competition in the U.S.-Italy market.

In the U.S.-Italy market,<sup>31</sup> **Alitalia** has the largest market share with 38.3 percent, compared to Continental with 20.6 percent; Delta with 14.1 percent; TWA with 9.9 percent; U.S. Airways with 5.8 percent; United with 5.7 percent; and American with 5.5 percent.<sup>32</sup> Based on this

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<sup>25</sup> For example, the U.S.-Europe nonstop passenger market share for Virgin Atlantic Airways was about 6.5 percent. Source: **T-100** and **T-100f Onflight** Market Data, calendar year ended December 1998.

<sup>26</sup> Source: **T-100** and **T-100f Onflight** Market Data, calendar year ended December 1998.

<sup>27</sup> The **DOJ** considers markets with a **HHI** between 1,000 and 1,800 to be moderately concentrated.

<sup>28</sup> The **DOJ** does not usually challenge post-merger concentrations under 1,800, if the increase in **HHI** caused by the merger does not exceed 100 points. In this case, the **HHI** increase is about 35 points.

<sup>29</sup> Contrary to Northwest's claim that it does not hold out service on a code-share basis in the U.S.-Italy market, the **IAM** maintains that Northwest does use its designator code on flights between Minneapolis and Rome through Amsterdam on **KLM**. Answer at 7. While our review of operations in the market shows that Northwest and **KLM** provide connecting services in the Minneapolis-Rome market over Amsterdam, Northwest does not use its designator code on **KLM** flights in the **Amsterdam-Rome** market. Source: **OAG Official Traveler**, October 1999.

<sup>30</sup> Joint Reply of September 1, at 7. For example, **Alitalia** and **KLM** conduct code-share operations in the Amsterdam-Rome market. Source: **OAG Official Traveler**, October 1999. The carriers state that they do not plan to offer joint flights to and from the United States until the U.S.-Italy Open-Skies agreement is signed and their proposed alliance with Northwest is approved by the Department. Furthermore, they do not now hold authority from the Department to conduct joint/code-share flights to or from the United States.

<sup>31</sup> Neither Northwest nor **KLM** operate their own flights in the U.S.-Italy market.

<sup>32</sup> Source: **T100** and **T-100f Onflight** Market Data, calendar year ended December 1998.

present market-share distribution under a restrictive regulatory regime, we do not tentatively find that the proposed integration, coupled with the significant service opportunities as a result of the introduction of open skies, will enable the Joint Applicants to impede competition, charge **supra-competitive** prices, or to reduce service below competitive levels. In fact, a number of U.S. airlines have publicly stated that they will offer new services in the U.S.-Italy market as soon as they are able to do so.

To the contrary, we conclude that the new, expanded U.S.-Italy open-skies accord will foster new entry and enhanced competition in the U.S.-Italy aviation markets that would not otherwise occur.<sup>33</sup> Moreover, the proposed arrangement between Northwest and **Alitalia** is like an **end-to-end** combination. Northwest and **Alitalia** serve no common nonstop or single-plane markets, only one common European gateway (Amsterdam), and only one common U.S. gateway (Boston), which is not a hub for Northwest.

We therefore tentatively find that the alliance between Northwest and **Alitalia** will not eliminate or substantially reduce competition in any market. Competitors will have **free** and open access to the marketplace due to the U.S.-Italy Open-Skies accord. Moreover, based on our experience with other alliances, network effects are another important reason why we expect an open-skies agreement with Italy to result in more intense competition than now **exists**.<sup>34</sup> We fully expect that Italy will become an important spoke that will feed traffic through competing global networks. This is precisely the type of market envisioned and promoted by the U.S.-Italy **open-skies** accord and by our overall international aviation policy.

For these reasons, once open skies is effective, we see no regulatory barriers to entry by other U.S. airlines in this market. In fact, other U.S. airlines already provide nonstop service between the United States and Italy. American Airlines operates nonstop flights between Chicago's O'Hare Airport and Milan; Delta Air Lines operates nonstop flights between Atlanta and Rome, and between New York's **J.F.K.** International Airport and Milan/Rome; **Trans** World Airlines operates nonstop flights between New York's **J.F.K.** International Airport and Rome; United Airlines operates nonstop flights between Washington's **Dulles** International Airport and Milan; and U.S. Airways operates nonstop flights between Philadelphia and Rome.

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<sup>33</sup> Importantly, we note that American Airlines, Delta Air Lines, **and** United Air Lines have already applied to the Department for unrestricted authority to serve the U.S.-Italy market. **See** Dockets **OST-1999-6085**, **OST-1999-6170**, and **OST-1999-6208**, respectively.

<sup>34</sup> Significantly, Docket **OST-1999-6208**, we note that United Air Lines in its application for expanded authority to serve the U.S.-Italy market stated that it will now begin to "explore options for increasing United's on-line service to Italy, both in its own aircraft and through additional code-share service with its European partners such as **Lufthansa**, British Midland and **SAS**." Application at **5**.

### 3. The City-Pair Markets

The record shows that the two airlines do not compete on a nonstop basis in any city-pair market.<sup>36</sup> Indeed, Northwest neither has a code share/blocked-space arrangement with **Alitalia**, nor operates its own equipment on any U.S.-Italy city-pair route. The alliance therefore will not eliminate or substantially reduce competition in any city-pair market. Similarly, **Alitalia** does not operate competitive nonstop or single-plane service in any **Northwest-KLM** alliance market.

For these reasons, we tentatively find that the Alliance Agreements will benefit overall competition in the affected markets. The arrangement will enable the partners to operate more efficiently and to provide the public with a variety of on-line services, such as those planned by the Joint Applicants for the Minneapolis-St. Paul/Detroit-Milan/Rome markets. The integration of the partners' services will provide pro-competitive advantages that outweigh the possible negative affects on competition in the four markets.

### B. Public Interest Issues

Under Section 41309, we must determine whether the Alliance Agreements would be adverse to the public interest. Section 41308 requires a similar public interest examination. Except as noted, we tentatively find that approval of the Alliance Agreements will promote the public interest.

Open-Skies agreements with foreign countries give any authorized carrier from either country the ability to serve any route between the two countries (and open intermediate and beyond rights) if it so wishes. These agreements place no limits on the number of flights that carriers can operate, and carriers can charge any fare unless it is disapproved by both countries.<sup>37</sup>

It is in all these circumstances that we have tentatively found that approving the Alliance Agreements is likely to benefit the traveling public, taking into account the conditions imposed by the Department, and is unlikely to reduce competition significantly in any relevant markets, and is otherwise in the public interest.

## VII. Other Issues

In reaching these tentative determinations, we have carefully considered all other issues that have a bearing on the outcome of this case.

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<sup>35</sup> Consistent with 49 U.S.C. § 41716, Northwest and Continental filed their various marketing agreements with the Department for review. For example, the original governance and voting trust agreement was **filed** in February 1998; the master alliance agreement, including the prorate agreement and the code-share agreement were filed in July 1998; and a copy of the reciprocal frequent flyer program agreement was filed in November 1998.

<sup>36</sup> **Alitalia** offers nonstop service in the following U.S.-Italy city-pair markets: Boston/Los Angeles/San Francisco-Milan and New York's **J.F.K.** Airport/Miami-Milan/Rome. Source: BACK Information Services Division, **OAG** Schedules for October 1999.

<sup>37</sup> Order 92-8-13, August 5, 1992.

In its Answer to the Joint Application, TWA maintained that the applicants had not provided sufficient information for DOT to reach an informed judgment on the question of Continental's relationship to the proposed **Northwest/KLM/Alitalia** alliance. TWA said that this information was material to the outcome of this case because of Northwest's investment in Continental and because of the "potential restraint of trade that would exist if Northwest's ability to operate with antitrust immunity in this alliance were combined with its control of Continental. (TWA Answer, p.3)

In response to TWA's position, we directed the Joint Applicants to provide additional information on this and other issues in this case. The Joint applicants provided the additional information we requested. TWA did not respond to the amended record.

TWA's answer is based on the relationship of Continental to the Joint Applicants. Continental is now a significant competitor in the U.S.-Italy market. It is linked to **Alitalia** by a code-share agreement, which provides the parties with the largest share of that market. At the same time, Continental is linked to Northwest by agreements which provide for investment by Northwest in Continental. And Northwest and **KLM** are major transatlantic alliance partners.

However, we are satisfied on the basis of the information now available to us that Continental's relationship with any of the applicants in this case is not decisional because there is no linkage between Continental and the new alliance with respect to the services that we are proposing to authorize today. Continental is not a party to the proposed alliance; there is no evidence that it has reached any agreement regarding any future participation, and we now have no reason to doubt its assertion that its blocked-space-code share arrangement with **Alitalia** will compete with the proposed alliance.

Moreover, to ensure that we are in the position to evaluate any changes in the relationship between Continental and the alliance partners, we will require them to file for prior approval of any agreement which alters Continental's existing relationships with any of the alliance partners, if those changes affect the authority that we are proposing to grant.

TWA also argues that we should not act on the Joint Application here before it reaches a final decision on whether antitrust immunity should be renewed for the **NW/KLM** alliance. That alliance is operating pursuant to authority previously granted by the Department. That authority remains in effect until such time as we complete our review of this issue in Docket **98-3341**. Neither TWA nor any other party to this case has submitted any arguments or information that would cause us to reach a different result based on either the facts or circumstances of this case.

**ASTA** argues that we deny the joint application because it is opposed to any additional grants of antitrust immunity for the joint venture at issue in this proceeding. We disagree with **ASTA's** position. We have granted immunity to several alliances. Our initial examination of the effects of our actions indicates that immunized international airline alliances are, in general, **pro-**competitive and pro-consumer, and that antitrust immunity has contributed to this result by providing the parties with an opportunity for enhanced coordination that would not occur without immunity. See Order **99-4-17**, pp.15-16. As noted, the record in this proceeding shows that the

proposed alliance should increase service and competition in the U.S.- Italy market, and that the parties will not go forward with their joint venture without immunity. Consequently, the record shows that **ASTA's** position could deny the public the substantial benefits that are likely to flow from granting this proposed alliance antitrust immunity. **ASTA** has not presented any factors that would offset this important consideration.

In all these circumstances, having tentatively determined that the overall competitive effect of the Alliance Agreements is beneficial and consistent with our international aviation policy, we believe that the public interest favors the grant of antitrust immunity. In so stating, of course, we will continue to monitor closely the effects of an immunized alliance on consumers and on competition, to ensure that the immunized alliance continues to serve the public interest.

### **VIII. Tentative Grant of Antitrust Immunity**

We have the discretion to grant antitrust immunity to agreements approved by us under Section 41309 if we find that the public interest requires immunity. It is not our policy to confer antitrust immunity simply on the grounds that an agreement does not violate the antitrust laws. However, we are willing to grant immunity if the parties to such an agreement would not otherwise go forward, and if we find that the public interest requires the grant of antitrust immunity.

The record shows that Northwest, **Alitalia**, and **KLM** will not proceed with the Alliance Agreements without antitrust immunity.<sup>38</sup> The confidential documents submitted by the joint applicants support this conclusion. The Joint Applicants claim that they cannot accomplish the public benefits that they seek to achieve through the formation of this alliance absent antitrust immunity. They state that the proposed integration of services will surely expose them to antitrust risk, since they fully intend to establish a common **financial** objective, permitting them to compete more effectively with other strategic alliances. Additionally, they indicate that full operational integration will necessarily mean that they will coordinate all of their U.S.-Europe business activities, including scheduling, route planning, pricing, marketing, sales, and inventory control.<sup>39</sup>

Since the antitrust laws allow competitors to engage in joint ventures that are pro-competitive, we think it unlikely that the integration of the Joint Applicants' services violates the antitrust laws. Nevertheless, the record suggests that the Joint Applicants could be subject to extensive and burdensome antitrust litigation if we did not grant immunity. The record also persuades us that they will not proceed without it.

To the extent discussed above, we tentatively find that we should grant antitrust immunity to the Alliance Agreements. We also intend to review and monitor the Joint Applicants' progress in implementing the alliance, if we approve and immunize it, in order to ensure that they are

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<sup>38</sup> See Joint Application, Exhibit **JA-2**, Alliance Coordination Agreement, Article **4.2**.

<sup>39</sup> See application, at **6-8**.

<sup>40</sup> These arrangements between airlines are today commonplace. We are unaware of any holding that such arrangements violate the antitrust laws. Order **92-11-27** at **19**.

carrying out the arrangements pro-competitive aims. We will also require them to resubmit the Alliance Agreements for review by January 11, 2003, if we make final this tentative decision to approve and immunize the Alliance Agreements.

While tentatively concluding that we should approve and give immunity to the alliance, we find, as discussed next, that certain conditions appear necessary to allow us to **find** that our actions in these matters are in the public interest.

## **IX. IATA Tariff Coordination Issue**

As we have determined in other immunity cases, it is contrary to the public interest to permit alliances to participate in certain price-related coordination that is now immunized within IATA tariff coordination. We therefore tentatively condition our approval and grant of antitrust immunity in this case by requiring Northwest, KLM, and Alitalia to withdraw from participation in any IATA tariff conference activities that discuss any proposed through fares, rates or charges applicable between the United States and Italy, or between the United States and any other countries designating a carrier that has been granted antitrust immunity or renewal thereof by the Department for participation in similar alliances with a U.S. air carrier.<sup>41</sup>

Consistent with our earlier decisions, we therefore have tentatively decided to condition our grant of antitrust immunity to the Alliance upon the withdrawal by the Joint Applicants from IATA tariff coordination activities **affecting** through prices between the U.S. and Italy and between the U.S. and any other country that has designated a carrier whose alliance with a U.S. carrier has been or is subsequently given immunity by us. Under this condition, the Alliance carriers may not participate in IATA tariff coordination activities affecting fares, rates and charges between the United States and Italy and between the United States and the homeland(s) of their similarly-immunized alliance competitors. Through prices between the U.S. and other countries, as well as all local fares in intermediate and beyond markets, are not covered by the condition.<sup>42</sup>

We tentatively find that this condition is in the public interest for a number of reasons. The requested immunity includes broad coverage of price coordination activities among Northwest, KLM, and Alitalia. With respect to internal Alliance needs, tariff coordination through the IATA conference mechanism is duplicative and unnecessary. At the same time, one of the reasons that we tentatively **find** supports immunity for the proposed Alliance activities is the

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<sup>41</sup> This condition currently applies to prices between the United States and the Netherlands; between the United States and Germany (see Order **96-5-27** at **17**); between the United States and Scandinavia (see Order **96-11-1** at **23**); between the United States and Austria, Belgium, and Switzerland (see Order **96-6-33** at **23-24**); and between the United States and Chile (see Order **99-9-9**). Also, by letter dated May 8, 1996, Northwest and KLM indicated their willingness to limit voluntarily their participation in IATA (see Dockets **OST-96-1116** and **OST-95-618**).

<sup>42</sup> Under this condition, the Alliance carriers could not participate in IATA discussions of the total ("through") price (see **14 C.F.R. § 221.4**) between a U.S. point of origin or destination and an origin or destination in Austria, Belgium, Chile, Denmark, Germany, Norway, Sweden, Switzerland, and the Netherlands, or a homeland of a subsequently immunized alliance, whether such prices are offered for direct, on-line or interline service. They could, however, discuss local segment prices, **arbitraries** or generic fare construction rules that have independent applicability outside such markets. IATA activities covered by our condition would include all those discussing prices proposed for agreement, including both meetings and exchanges of documents such as those preceding meetings and those used in mail votes.



potential for increased price competition between the Alliance carriers and other carriers, particularly other international alliances. We have tentatively found that such potential competition will, on balance, outweigh any potential anticompetitive effects of price coordination within the Alliance itself and encourage the passing on of economic efficiencies realized by the Alliance to consumers in the form of lower prices. Permitting the Joint Applicants to continue tariff coordination within IATA undermines such competition.

## **X. O&D Survey Data Reporting Requirement<sup>43</sup>**

We have access to market data where our carriers operate, including markets that they serve jointly with foreign airlines, for example, the Department's Origin-Destination Survey of Airline Passenger Traffic (O&D Survey). We have also collected special O&D Survey code-share reports for three large alliances and have directed all other U.S. airlines to file reports for their transatlantic code-share operations beginning with the second quarter of 1996.

However, we receive no market information for passengers traveling to or from the U.S. when their entire trip is on foreign airlines, except for T-100 data for nonstop and single-plane markets. Such passengers account for a substantial portion of all **O&D traffic** between the U.S. and foreign cities, and the absence of such information severely handicaps our ability to evaluate the economic and competitive consequences of the decisions we must make on international air service.

In addition to the added importance of our decision-making regarding international issues, we must ensure that our grant of antitrust immunity does not lead to anticompetitive consequences. We have therefore tentatively decided to require **Alitalia** to report full-itinerary **Origin-Destination Survey of Airline Passenger Traffic** for all passenger itineraries that contain a United States point (similar to the O&D Survey data already reported by Northwest)?

To prevent this reporting requirement from having any anti-competitive consequences, we have tentatively decided to grant confidentiality to **Alitalia's** Origin-Destination report and special report on code-share passengers. Currently, we grant confidential treatment to international Origin-Destination data. We provide these data confidential treatment because of the potentially damaging competitive impact on U.S. airlines and the potential adverse effect upon the public interest that would result from unilateral disclosure of these data (data covering the operations of foreign air carriers that are similar to the information collected in the Passenger O&D Survey are generally not available to the Department, to U.S. airlines, or to other U.S. interests).

14 C.F.R. Part 24 1 section 19-7(d)(1) provides for disclosure of international Origin-Destination data to air carriers directly participating in and contributing to the O&D Survey. While we have

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<sup>43</sup> We will provide confidentiality protection for these data, as we do for international O&D data submitted by U.S. airlines. Although we will use these data for internal monitoring purposes, we will not disclose it to any other airlines.

<sup>44</sup> Consistent with our determinations in Orders **96-7-21**, **96-11-1**, and **99-9-9** we intend to request other foreign carrier members of immunized international alliances involving U.S. carriers to submit **O&D** Survey data and condition any further grants or renewals of antitrust immunity on provision of such data. We will treat the foreign carriers' O&D data as confidential, will not allow U.S. carriers any access to the data, and will not allow **Alitalia** or other foreign carriers any access to U.S. carrier O&D Survey data.

tentatively found it appropriate to direct **Alitalia** to provide certain limited Origin-Destination data to the O&D Survey, **Alitalia** is not an air carrier within the meaning of Part 241.

14 C.F.R. Part 241, Section 03 defines an air carrier as “[a]ny citizen of the United States who undertakes, whether directly or indirectly or by a lease or any other arrangement, to engage in air transportation.” **Alitalia** accordingly will have no access to the data filed by U.S. air carriers. Moreover, we will be making **Alitalia's** submissions confidential while maintaining the current restriction on access to U.S. air carrier Origin-Destination data by foreign air carriers.

## **XI. Operation under a Common Name/Consumer Issues**

Since operation of the Alliance Agreements could raise important consumer issues and “holding out” questions, if the joint applicants choose to operate under a common name or use “common brands,” they will have to seek separate approval from the Department prior to such operations. For example, it is Department policy to consider the use of a single air carrier designator code by two or more carriers to be unfair and deceptive and in violation of the Act unless the air carriers give reasonable and timely notice to passengers of the actual operator of the aircraft.<sup>45</sup>

## **XII. Summary**

We tentatively grant approval and antitrust immunity to the Alliance Agreements. We also tentatively direct the Joint Applicants to resubmit the Alliance Agreements by January 11, 2003. However, the Department is not authorizing the joint applicants to operate under a common name. If the joint applicants wish to operate under a common name, they will have to comply with our relevant procedures before implementing the change.

We also tentatively direct the Joint Applicants to withdraw from all International Air Transport Association (**IATA**) tariff conference activities relating to through fares, rates or charges between the United States and Italy, as well as between the United States and the homeland of any other foreign carrier granted antitrust immunity or renewal thereof, by the Department for participation in similar alliance activities with a U.S. carrier; and file all subsidiary and/or subsequent agreement(s) with the Department for prior approval. We also tentatively direct **Alitalia** to report full-itinerary Origin-Destination Survey of Airline Passenger Traffic for all passenger itineraries that contain a United States point (similar to the O&D Survey data already reported by Northwest).

Objections or comments to our tentative findings are due no later than Thursday, December 2, 1999. Answers to the objections shall be due no later than Friday, December 3, 1999.

### **ACCORDINGLY:**

1. We direct all interested persons to show cause why we should not issue an order making final our tentative findings and conclusions, granting approval and antitrust immunity as limited and discussed by this order to a Commercial Cooperation and Integration Agreement and an Alliance Coordination Agreement among Northwest Airlines, Inc., **KLM** Royal Dutch Airlines,

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<sup>45</sup> See 14 C.F.R. 399.88.

and **Alitalia-Linee Aeree Italiane S.p.A** effective upon implementation of the open-skies provisions of the agreement between Italy and the United States;

2. We tentatively direct Northwest Airlines, Inc., **KLM Royal Dutch Airlines**, and **Alitalia-Linee Aeree Italiane S.p.A.** to resubmit their Commercial Cooperation and Integration Agreement and their Alliance Coordination Agreement no later than January 11, 2003;
3. We tentatively direct Northwest, **Alitalia**, **KLM** and Continental, or any other airline involved in such arrangements, to file for prior approval a copy of any agreement which may affect the **Northwest/KLM/Alitalia** alliance services;
4. We tentatively direct interested persons to show cause why we should not further condition our grant of approval and immunity to require Northwest Airlines, Inc., **KLM Royal Dutch Airlines**, and **Alitalia-Linee Aeree Italiane S.p.A.** to withdraw **from** participation in any International Air Transport Association (**IATA**) tariff conference activities that discuss any proposed through fares, rates or charges applicable between the United States and Italy, and/or between the United States and any other countries whose designated carriers participate in similar agreements with U.S. airlines that are subsequently granted antitrust immunity or renewal thereof by the Department;
5. We tentatively direct **Alitalia-Linee Aeree Italiane S.p.A.** to report full-itinerary **Origin-Destination Survey of Airline Passenger Traffic** for all passenger itineraries that include a United States point (similar to the O&D Survey data already reported by its alliance partner Northwest Airlines, Inc.);
6. Our tentative decision, if made final, will be subject to the **terms**, conditions, provisions and limitations previously imposed on Northwest Airlines, Inc. and **KLM Royal Dutch Airlines** in Order **93-1-11**;
7. We direct interested persons wishing to comment on our tentative findings and conclusions, or objecting to the issuance of the order described in ordering paragraphs **1-6** to file an original and five copies in Docket **OST-1999-5674** and to serve a statement of such objections or comments together with any supporting evidence the **commenter** wishes the Department to notice on all persons on the service list in that docket no later than Thursday, December 2, 1999. Answers to objections shall be due no later than Friday, December 3, 1999.<sup>46</sup>
8. If parties file timely and properly supported objections, we will afford full consideration to the matters or issues raised by the objections before we take further action. If no objections are filed, we will deem all further procedural steps to have been waived;

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<sup>46</sup> Service should be by hand delivery or **telefax**. The original filing should be on 8 ½" by 11" white paper using dark ink and be unbound without tabs, which will expedite use of our docket imaging system. In the alternative, filers are encouraged to use the electronic submission capability through the Dockets **DMS** Internet site (<http://dms.dot.gov>) by following the instructions at the web site. For the convenience of the parties, service by facsimile is authorized. Parties should include their fax numbers on their submissions and should indicate the method of service on their certificates of service.

9. We grant all motions for leave to file otherwise unauthorized documents; and
10. We shall serve this order on all persons on the service list in this docket.

By:

**A. BRADLEY MIMS**  
Deputy Assistant Secretary for Aviation  
and International Affairs

(SEAL)

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